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IN THE

Supreme Court of the United States

OCTOBER TERM, 1965

No. 132

MARGARET L. HOLT and KATHLEEN L. McMAHON, individually and on behalf of all other shareholders of ALLEGHANY CORPORATION similarly situated,
Petitioners,

against

ALLAN P. KIRBY, CHARLES T. IRELAND, JR., FRED M. KIRBY AND ALLEGHANY CORPORATION,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

Statement in Opposition to Motion of Randolph Phillips, dated February 4, 1966, for Leave to File a Brief and to Make Oral Argument as *Amicus Curiae*

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Phillips' motion rests on a misconstruction of petitioners' brief, and an incomplete recital of the relevant proceedings below. It clarifies, however, the fact that this proceeding is a true collateral attack on a state court judgment, based on a claim of preemption, and not a bill for relief from fraud. Both Phillips and petitioners contend in essence that the existence of the Securities Exchange Act, §§ 14(a) and 27, 15 U.S.C.A. §§ 78n, 78aa

(1963), deprived the New York court of jurisdiction over the *Zenn** stockholders' suit, even though the court decided that the cause of action was rooted in state law, not the Securities Exchange Act (Ex. K-137, R. 1640-41; Ex. K-138, R. 1720).**

We oppose Phillips' motion on five grounds:

(1) Phillips' petition misstates the course of the proceedings in *Zenn*, where the issue of the state court's jurisdiction in the light of § 27 of the Securities Exchange Act was adjudicated not once but twice, no review being sought in this Court. General counsel for the plaintiff stockholders in *Zenn*, the draftsman of the complaint there, expressly supported the decision of the New York courts that *Zenn* was a suit to enforce state law, not one to enforce liabilities and duties created by the Securities Exchange Act.

(2) The Court of Appeals en banc was correct in its view that the New York courts' decisions on the jurisdic-

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* *Zenn, et al.* v. *Anzalone, et al.*, N. Y. Sup. Ct. N. Y. Co., Index No. 7244/1954 (Ex. 1, R. 701, opinions, Ex. K-137, R. 1592-1716; Ex. K-138, R. 1717-1720). Two related proceedings in the District Court for the Southern District of New York are linked in various ways to this action, but are not directly involved in this appeal, or this motion.

** In a diversity case dealing with a question found to be one of state law, a federal court can set aside a New York judgment only on grounds which would justify collateral attack if like proceedings had been brought in a New York court. Reiter v. Universal Marion Corp., 299 F. 2d 449, 453 (D.C. Cir. 1962); O'Boyle v. Bevil, 259 F. 2d 506, 511-12 (5th Cir. 1958); *cf.*, Curb & Gutter Dist. No. 37 v. Parrish, 110 F. 2d 902, 907, 910 (8th Cir. 1958); Caterpillar Tractor Co. v. International Harvester Co., 120 F. 2d 82, 85-86 (3d Cir. 1941) (rule applied between district courts sitting in different states); 7 Moore, Federal Practice 633-34 (2d ed. 1955); *cf.* Griffith v. Bank of New York, 147 F. 2d 899 (2d Cir. 1945), *cert. denied* 325 U. S. 874 (1945) where, however, the court found compliance with New York law in any event. Id at 903.

tion of the court in *Zenn* are res judicata, and entitled to full faith and credit.

(3) Phillips* states that petitioners have abandoned question 5 of the Questions Presented in their Petition for Certiorari. This is not so. Dressed in the language of questions 1 and 2 of their Petition, question 5 is the cornerstone of their argument.

(4) Kirby, although he had not theretofore been served or appeared, was made a party to the *Zenn* court's judgment approving the supplemental stipulation of settlement (Ex. K-357, R. 2112), and is fully entitled to claim the benefit of the *Zenn* judgment as res judicata. He in no way "misled" the Court of Appeals below as to the decisions on jurisdiction in *Zenn*.

(5) The motion is not timely under this Court's Rule 42(2), and is otherwise objectionable.

The Background of Phillips' Motion

The sole issue alleged, tried below and appealed in the present proceeding (*"Murchison"*)* was whether respondent Allan P. Kirby ("Kirby") defrauded the *Zenn* court by concealing "inside information" consisting of favorable income forecasts of Investors Diversified Services, Inc. ("IDS"), a Minnesota investment company, which he knew or should have known at the time of a certain transaction in 1949 and early 1950 (R. 174-75). The relief sought was the setting aside of Kirby's separate settlement in *Zenn* (R.187-89).

* *Murchison, et al.* v. *Kirby, et al.*, U. S. Dist. Ct., S.D.N.Y., 60 Civ. 3511 (R. 166). Opinions below, R. 2287-2388.

The District Court found after trial that the plaintiff had failed to prove any wrongdoing by Kirby (R. 2325). On appeal with respect to that issue—the only issue pleaded and tried—the Court of Appeals unanimously affirmed, finding, in the words of the dissenting opinion, that "insofar as the plaintiff's case here hinged upon establishing personal dereliction by Kirby with respect to the settlement hearings, this was not made out" (R. 2351).

The dissent, however, adopted a suggestion made for the first time upon appeal, that two other *Zenn* defendants (Robert R. Young and Robert W. Purcell) committed a "fraud" upon the *Zenn* court, for which Kirby should be held responsible. The only support offered by the dissent for this theory was a statement of petitioners' counsel during the trial below, which the dissent truncated in such a way as to make it appear to state the opposite of what the record shows to have been said (R. 2351). The actual statement of petitioners' counsel (R. 606) was:

> "Mr. Updike: Well, it seems to me, sir, that if Mr. Kirby entrusts the responsibility to some extent of his being a director of Alleghany, if he entrusts some of that responsibility to Mr. Young, then Mr. Kirby cannot avoid accepting the consequences of whatever Mr. Young may have done, *and I do not say that it was Mr. Young and I do not say for a moment that it was Mr. Purcell, and I do not know who is responsible.*" (Italics added.)

The dissent (R. 2351) omitted the italicized portion above, which showed that petitioners' counsel was explicitly disclaiming any fraud by Young or Purcell, and quoted the first part as the sole basis for its theory that counsel was claiming such liability.

No such claim against Kirby based on the conduct of Young or Purcell was alleged, suggested or tried before

the District Court. On the contrary, petitioners specifically disclaimed any such wrongdoing by Young and Purcell, or any claim that Kirby was jointly responsible with them. Throughout the trial, petitioners' counsel, draftsman of the amended complaint in *Murchison*, took the view that the complaint raised no issues with respect to actions by Young, Purcell, or anyone except Kirby.* Furthermore, the record contradicts the dissent's suggestion that these parties acted jointly or that there was fraud on the part of Young and Purcell.

The Evolution of the Jurisdictional Issue

In *Zenn*, plaintiffs and objectant stockholders (to whom Phillips was a consultant) claimed, *inter alia*, that the transaction was fraudulent as a matter of common law (Ex. 1, R. 702-04) because Kirby, Young and Purcell kept favorable inside information from the stockholders who ratified it. In addition, they claimed the transaction was objectionable because ratified on the basis of a proxy statement which violated §14(a) of the Securities Exchange Act, 15 U. S. C. A. §78n (1963) (Ex. 1, R. 704-05). The alleged concealment of this "inside information" was pressed in *Zenn* by objecting stockholders as a reason for not approving the settlement as fair and adequate. (Ex. K-41, R. 1504-14, 1517-21, 1523-26, 1530-31). The only difference in this respect between *Zenn* and *Murchison* turns on the inferences to be drawn from the existence of 12 documents (not in evidence in *Zenn*) which petitioners'

* This was made doubly clear in plaintiffs' successful resistance to Kirby's defense that indispensable parties had not been joined. (R. 206). Petitioners' counsel said, "Far from being indispensable parties the absent *Zenn* defendants are not even proper parties and would be entitled to summary judgment were plaintiffs to have sought to join them here." (Plaintiff's Post-trial Reply Br., p. 45).

counsel found in a new search of the files of Kirby, Alleghany and particularly of IDS (which was in the control of the Murchisons during the pendency of *Zenn*.)

The courts below gave a short answer to the contentions of petitioners' counsel based on these documents. The 12 documents, they found, whether connected with Kirby, Young, or Purcell, were at most cumulative of evidence already before the Referee in *Zenn*.

Judge Dawson concluded that these documents, "which were not called for at the hearings and most of which were not in [Kirby's] possession but were in the possession of IDS" (R. 2325) were not "of such significance that they would warrant the Court upsetting the decision of the State court in any event" (R. 2324).

Judge Moore, for the majority of the Court of Appeals panel below, concluded that at most, the documents "would have been but cumulative evidence upon the basic issue of Kirby's fraud" in *Zenn* (R. 2342). Judge Kaufman, concurring below, found the documents basically cumulative of information already before the Referee in *Zenn*, and not "sufficient to warrant upsetting the New York judgment as against Kirby" (R. 2349).

These concurrent findings of fact dominate the case.*

Faced with the force of Rule 52(a) as to their 12 documents, petitioners' counsel attacked the jurisdiction of the

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* Unless the Court reverses the findings as "clearly erroneous" under Rule 52(a) Fed. R. Civ. P., it cannot and should not reach the questions raised in one form by Phillips, and in another by petitioners. This Court has always regarded itself as "concluded" by such concurrent findings of fact by two courts below, in the absence of a "very exceptional showing of error." Comstock v. Group of Institutional Investors, 335 U. S. 211, 214 (1948); Graver Mfg. Co. v. Linde, 336 U. S. 271, 275 (1949), *aff'd on rehearing*, 339 U. S. 605 (1950); Pick Mfg. Co. v. G. M. Corp., 299 U. S. 3 (1936). Petitioners make no attempt in their brief or their petition to challenge these findings directly.

state court in *Zenn*. That attack was correctly rejected by a unanimous opinion of the Court of Appeals for the Second Circuit, sitting en banc.

Petitioners have re-presented their jurisdictional attack in the form of an argument based on preemption. Randolph Phillips now seeks leave to present the jurisdictional argument in the form in which it was unanimously rejected by the Court of Appeals.

Phillips' motion for leave to file a brief amicus curiae should be denied for the reasons set forth below.

Argument

1. Phillips' Motion and Brief do not completely or correctly report the decisions on jurisdiction made by the New York courts in *Zenn*.

With emphasis, Phillips' brief (p. 6) states that the 1955-1956 decisions by the New York courts constitute "the entire record on which the court below decided that the jurisdictional issue was *res judicata*."

The record is to the contrary.

On October 6, 1955, objectant Rosen moved in the New York Supreme Court in *Zenn* to enjoin any further settlement proceedings before the Referee on two grounds, one of which was that the court lacked jurisdiction over the claimed violation of §14(a) mentioned in the complaint because of the "exclusive jurisdiction" provision of §27. The court denied the motion, and the Appellate Division, First Department, affirmed and denied leave to appeal to the Court of Appeals, *Zenn* v. *Anzalone*, 1 App. Div. 2d 662, 146 N.Y.S. 2d 286 (1955); 1 App. Div. 2d 773, 149 N.Y.S. 2d 213 (1956). No attempt was made to petition for certiorari.

The Appellate Division's consideration of the problem on objectant stockholders' motion was far from perfunctory. The motion was most seriously contested. We attach as an appendix the brief of Thomas F. Daly, Esq., counsel for defendants* on the appeal to the Appellate Division, First Department, from the denial of the motion by a Justice of the Supreme Court in New York. Phillips quotes a passage from pp. 15-16 of this brief (Br. p. 7). But he neglects to point out that from p. 3 to p. 15, Mr. Daly argued in most positive form for a conclusive determination of jurisdiction. The passage Phillips quotes is obviously an alternative, "fall-back" argument, in the event the Court disagreed with his major contention.

Furthermore, the record in *Zenn* shows that William E. Haudek, Esq., a partner of Pomerantz, Levy and Haudek, general counsel for the *Zenn* plaintiffs—the draftsmen of the complaint—opposed Rosen's jurisdictional motion on the ground that the complaint stated "a claim arising under the common law", and that the reference to §14(a) was merely duplicative of the common law aspects of the case, and, surplusage. His affidavit in opposition, which was before both the New York Supreme Court and its Appellate Division, stated:

> "(2) The allegation of the complaint referring to §14 of the Securities Exchange Act is but a legal conclusion. There is nothing in the complaint to suggest that the Securities Exchange Act was to be the basis, let alone the only basis, of the first cause of action. The facts alleged in the first cause of action, including those relating to the false proxy statement, clearly state a claim arising under the common law; see In re Scheuer, 50 N. Y. Supp. 2d 500, 501 (S. Ct., N. Y. Co., 1942); Matter of R. Hoe

* Mr. Daly's representation did not include Kirby.

> & Co., 137 N. Y. Supp. 2d 142, 148 (S. Ct., Bronx Co., 1954). This Court has undoubted jurisdiction to pass upon this common law claim even if it be coterminous with a possible federal claim." (p. 44*).

If, as Phillips claims (Br. p. 10), the party who brings the suit really is master to decide what law he will rely upon, Mr. Haudek's affidavit should end the matter.

In addition, Phillips must have overlooked the fact that when the issue was raised before the Referee, he ruled upon it in his decision of November 17, 1958, (R. 1640-41) in these terms:

> "Before discussing the merits of these charges and defenses, I must consider the objections which have been made, particularly by the objectant Rosen, to the jurisdiction of this Court to pass upon the settlement of this cause of action.
>
> "The objection is based on the contention that the first cause of action rests in part at least upon the Securities Exchange Act of 1934, and that Sec. 27 of that Act vests in the Federal Court exclusive jurisdiction of all claims based thereon.
>
> "This jurisdictional question was raised by objectant Rosen at Special Term of this Court in the form of a motion to vacate the order of reference herein. This motion was denied by Mr. Justice McGivern, and his decision was affirmed by the Appellate Division, First Department (1 App. Div. 2nd 662, 146 N.Y.S. 2d 286, Exhibit 411).
>
> "While it is doubtful if anything remains of the jurisdictional question after these decisions, even that doubt has been resolved by the recent decision

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* "Papers on Appeal from Order" in *Zenn* before the Appellate Division of the New York Supreme Court, 1st Department, October 26, 1955, "Affidavit in Opposition to the application of Samuel R. Rosen."

of the United States Court of Appeals for the Second Circuit, in Howard *vs.* Furst, 238 F. 2d 790 (1956). Upon substantially similar facts to those at bar, the Court of Appeals with reference to a cause of action based, as here, upon a false proxy statement, held that 'every essential element of appellant's case depends upon common law and the statutes of the State of New York,' and that 'appellant's claim is for violation of State created rights, in no real or substantial sense dependent upon the provisions of the Securities Exchange Act of 1934 relative to proxy statements;' so that 'the allegations with reference to the proxy statement constitute a mere excrescence or superfluity tacked on to what are otherwise sufficient allegations of a claim for relief under New York law.'

"Accordingly, the Court of Appeals affirmed the judgment of the District Court, which dismissed the Complaint for lack of jurisdiction over the subject matter.

"Since Howard *v.* Furst, *supra,* in all essential respects is similar to the case at bar, it follows that the provision of the Securities Exchange Act, conferring exclusive jurisdiction upon the Federal Courts, is inapplicable here, and that this Court does have jurisdiction to pass upon the fairness of the settlement of this litigation, including the first cause of action in the Complaint."

The Report of the Referee was confirmed by the Supreme Court of New York, and "adopted as the decision" of that court (Ex. K-138, R. 1720). The final orders of the Supreme Court approving the settlement in *Zenn* were appealed to the Appellate Division, First Department, which dismissed the appeals without opinion. *Zenn* v. *Anzalone,* 10 App. Div. 2d 912 (1st Dep't 1960), 11 App. Div. 2d 938, 210 N. Y. S. 2d 748 (1st Dep't 1960).

The New York courts thus decided repeatedly that the gravamen of Count I of the complaint in *Zenn* was rooted in state law, not in §14(a) of the Securities Exchange Act, and that the *Zenn* court therefore had jurisdiction of the case. No effort was made by Phillips (who was actively engaged in *Zenn*) or by any other stockholder or stockholders' group to obtain further appellate review, in the Court of Appeals of New York or in this Court, of the Supreme Court's decision.*

2. The litigated decision of a New York court on its subject matter jurisdiction is entitled to full faith and credit, as the Court of Appeals held here.

The New York courts passed on the jurisdictional questions not once, but twice. Their decisions could have been reviewed by direct appeals to the Court of Appeals of New York and to this Court. This was not done. In this state of the record, the litigated decisions of the New York court on its jurisdiction and on the nature of the case before it are entitled to full faith and credit, and are res judicata. *Durfee* v. *Duke,* 375 U. S. 106, 111, 116 (1963); *Cook* v. *Cook,* 342 U. S. 126 (1951); *Sherrer* v. *Sherrer,* 334 U. S. 343, 350 (1948); *Coe* v. *Coe,* 334 U. S. 378 (1948); *Davis* v. *Davis,* 305 U. S. 32, 40 (1938); *Treinies* v. *Sunshine Min. Co.,* 308 U. S. 66, 78 (1939); *Baldwin* v. *Iowa State Travelling Men's Ass'n,* 283 U. S. 522, 525-26 (1931); *American Surety Co.* v. *Baldwin,* 287 U. S. 156, 166-67 (1932).

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* Phillips was an active participant in *Zenn*, associated with counsel for objectant stockholders who pursued the jurisdictional issue. (R. 481-82). His brief does not explain why he is not now estopped to attack objectant stockholders' decision to make peace and consent to the judgment approving the settlement.

Thus petitioners are forced to invoke extreme doctrines of preemption, and must claim now, as Phillips does frankly, that the existence of §27 of the Securities Exchange Act would permit this Court to treat as totally void the entire elaborate six-year proceeding in *Zenn*—motions, hearings, settlements, judgments and all—disregarding the jurisdiction expressly left in the states under §28 of the same Act.*

There is no hint of support in *J. I. Case Co.* v. *Borak*, 377 U. S. 426 (1964) for such a position. That case was a direct review of one aspect of a federal court proceeding found by the trial court to be based on the Securities Exchange Act. The Court could not and did not consider the problem of collateral attack by federal courts on state court judgments—the sole issue in the present proceeding—and did not qualify or weaken the authority of *Durfee, American Surety Co.* v. *Baldwin* and the other cases mentioned above, in any way. The principle of finality which those decisions represent is fundamental to the orderly life of any judicial system, and particularly of our federal system.

Phillips seeks to invoke *Borak* obliquely by inferring that the Referee was relying on cases overruled in *Borak*. (Br., pp. 14-15). But *Borak* does not deal with the status of a state court judgment determining that the case before it was rooted in state law, rather than the Securities Exchange Act. In *Borak* the Court was at pains carefully to distinguish *Dann* v. *Studebaker Pack-*

* Section 28 of the Securities Exchange Act provides "(a) The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity . . .". The jurisdiction of state regulatory agencies is also specifically preserved. 15 U.S.C.A. §78bb (1963).

ard Corp., 288 F. 2d 201 (6th Cir. 1961), where this Court said, "it was held that the 'preponderance of questions of state law which would have to be interpreted and applied in order to grant the relief sought . . . is so great that the federal question involved . . . is really negligible in comparison.'" 377 U. S. at 434. This finding was parallel to that made by New York courts in *Zenn*. The issue before this Court in *Borak* was whether the federal courts were limited under §27 to declaratory relief in civil suits to enforce the Securities Exchange Act. *Borak* decided that in a case which the lower court found to be one to enforce duties or liabilities created by the Securities Exchange Act, the federal court could provide all forms of judicial relief necessary to resolve the controversy before it in the light of the policies of the Act.

The clarification of the law of remedies accomplished by *Borak* defines another aspect of the problem of res judicata raised by Phillips. Since the jurisdictional issue raised in *Zenn* was decided in accordance with the state of the law as it then existed, the final *Zenn* judgment should not now be disturbed because of a change in decisional law made five years after that judgment was entered.

As movant Phillips points out (Br., p. 14), under the federal decisional law as it existed throughout the course of the *Zenn* proceedings, no private or derivative right to full remedial relief was recognized as generally available for a violation of §14(a). See *Dann* v. *Studebaker Packard Corp.*, 288 F. 2d 201 (6th Cir. 1961); *Howard* v. *Furst*, 283 F. 2d 790 (2nd Cir. 1956), *cert. denied*, 353 U. S. 937 (1957). It was in reliance on the law as it then existed that the *Zenn* Referee, in his report, rejected objectant Rosen's jurisdictional challenge (R. 1640-41).

Zenn was therefore not a case where the state court attempted to evade the effect of the federal jurisdictional legislation. On the contrary, the state court applied the federal decisional law as it then existed, and under which full relief could be had only under state law. The law of New York did, and still does provide relief for injuries resulting from the use of false or misleading proxy statements., *E.g., Wyatt* v. *Armstrong,* 186 Misc. 216, 59 N.Y.S. 2d 502 (S. Ct. N. Y. Co. 1945); *Hecht* v. *Farnsworth T.V. & Radio Corp.,* 89 N.Y.S. 2d 724 (S. Ct., N. Y. Co. 1949).* See Securities Exchange Act §28, 15 U.S.C.A. §78bb (1963).

Some four years after *Zenn* was finally decided, as Phillips points out (Br. pp. 14-15), this Court clarified the remedial law of the Exchange Act. *J. I. Case Co.* v. *Borak,* 377 U. S. 426 (1964). But a change in the decisional law, after all proceedings in an action have been completed and a final judgment entered, is no ground for collateral attack on the jurisdiction of the court which rendered that judgment. *Chicot County Drainage Dist.* v.

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* Movant's cases at pp. 13 and 15 of his brief do not bear on the problem. Thus only violations of the Securities Exchange Act were pleaded in American Distilling Co. v. Brown, 295 N.Y. 36, 64 N.E. 2d 347 (1945) (§16(b) claim for short-swing profits); Mekrut v. Gould, 16 Misc. 2d 326, 188 N.Y.S. 2d 6 (S. Ct., N. Y. Co. 1959) (§8 claim for failure to meet capital requirements); Standard Power & Light Corp. v. Investment Ass'n, 51 A. 2d 572, 579, 29 Del. Ch. 593 (1947) (X-14A-1 claim for failure to include proxy statement when soliciting proxy). In Levine v. Silverman, 43 Misc. 2d 415, 251 N.Y.S. 2d 68 (S. Ct., Monroe Co. 1964), the New York court struck a §10(b) claim for lack of jurisdiction, but nonetheless allowed the complaint to stand on the same facts insofar as it stated a claim under New York law. Malkan v. General Transistor Corp., 27 Misc. 2d 677 207 N.Y.S. 2d 345 (S. Ct., Queens Co. 1960), was an anticipation by a New York court of what *Borak* thereafter held. For a similar anticipation by a federal court, also after *Zenn*, see Kauder v. United Board & Carton *Corp.*, 199 F. Supp. 420, 421 (S.D.N.Y. 1961).

Baxter State Bank, 308 U. S. 371 (1940); *Ripperger* v. *A. C. Allyn & Co.*, 113 F. 2d 332, 333 (2d Cir.), *cert. denied*, 311 U. S. 695 (1940). "If such was the rule, so-called final judgments would lose most of their finality." *Berryhill* v. *United States*, 199 F. 2d 217, 219 (6th Cir. 1952).

3. Petitioners have not abandoned question 5 of their Questions Presented.

The sole ground advanced to justify Phillips' appearance as amicus curiae is that petitioners have "abandoned" question 5 of the Questions Presented in their Petition for Certiorari.* But Phillips' position rests on a misapprehension of petitioners' brief. Petitioners' entire legal argument here rests on the substance of question 5.

Petitioners' brief recognizes that their collateral attack on the jurisdiction of the New York court in terms of the theory of question 5 faces insuperable obstacles, by reason of the New York courts' decisions on jurisdiction. Cases like *Durfee* and *American Surety Co.* v. *Baldwin, supra*, bar any attempt to urge question 5 in the form in which it was framed.

Petitioners are likewise aware that the plan of the Securities Exchange Act is not one of wholesale preemption of state law. It is not the federal incorporation law which Congress has often considered, but never passed. It does not supersede state blue-sky laws, state corporation laws for companies doing interstate business, or state court jurisdiction in stockholders suits and other suits in which state corporation laws, and laws against

* "5. Did the state court have jurisdiction to authorize the settlement of the exclusive federal claim being asserted here? If not, can that court's approval of the settlement bar prosecution of that claim which is still pending in the federal district court?" Petition for Certiorari, p. 4.

fraud, are interpreted. *Cohen* v. *Beneficial Indus. Loan Corp.*, 337 U. S. 541 (1949). On the contrary, its plan is to superimpose federal rights and duties on those created by state law, as §28 of the Act makes clear, with peaceful coexistence contemplated for both. In this respect, the Congressional purpose in passing the Securities Exchange Act was altogether different from the approach it adopted in seeking to bring the chaotic and dangerous strife between labor and management under the control of law in its basic labor legislation of 1935 and 1937, *San Diego Building Trades Council* v. *Garmon*, 359 U. S. 236, 240, 244-46 (1959); *Hanna Min. Co.* v. *Dist. 2, M. E. B. A.*, 86 S. Ct. 327, 331-32 (Dec. 6, 1965)*

Conscious of these hurdles, petitioners' counsel present the issue of question 5 indirectly in the language of questions 1 and 2 of the Questions Presented.** They seek a

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* Nor is the problem of the *Zenn* court's jurisdiction in the light of §27 comparable in any way to that considered in Kalb v. Feuerstein, 308 U. S. 433 (1940), where the court carried out the express purposes of Congress in passing the Frazier-Lemke Act, 11 U.S.C.A. 203 (1946) for the relief of farmer debtors during the depression of the 'Thirties. There the Congressional purpose was to protect farmers completely against mortgage foreclosure *once a farmer filed his petition under the Frazier-Lemke Act.*

** "1. Where federal statutes (Section 14(a) of the Securities Exchange Act of 1934 and Rule X-14A-9) impose upon corporate directors standards of disclosure deemed necessary for the protection of the interests of minority shareholders, must a federal district court apply a comparable federal standard of disclosure in determining whether derivative actions alleging violation of those statutes have been fraudulently settled?

"2. If application of a comparable federal standard of disclosure requires that the settlement be set aside, should the fact that such settlement had been approved by a state court judgment prevent a federal district court from barring the use of such judgment in a pending parallel federal action or from setting that settlement aside because of (a) the doctrine of *Erie* v. *Tompkins*, (b) the principles of *res judicata*, or (c) considerations of comity, even though the fraud leading to the settlement has been committed on the federal as well as the state court?" Petition for certiorari, p. 3.

review of the New York courts' jurisdiction by claiming that *Zenn* can be treated as a case under §14(a) of the Securities Exchange Act—despite the New York courts' final determination that it wasn't—for two purposes: (1) to determine what constituted a "fraud" on the state court in *Zenn,* and (2) to invoke the "fraud" so described as a ground justifying collateral attack by a federal court on a state court judgment.

Petitioners use this circuitous route to seek a review of the Court of Appeals' unanimous en banc decision rejecting the position advanced by Phillips because a frontal attack is barred by the force of the law on which the Court of Appeals based its determination. Petitioners therefore argue that §14(a) of the Securities Exchange Act, dealing with the process of soliciting stockholder votes, should be interpreted to establish a special burden of enquiry and of coming forward which the New York court should have required Kirby to meet; equally, that it should be read to establish a special standard defining the availability of collateral attack on state court judgments for "fraud." A new team of lawyers in this proceeding has gone over the files of Kirby, Alleghany and especially of IDS (under the control of the Murchisons while *Zenn* was pending) and found some 12 documents which stockholders' counsel in *Zenn* either missed or decided not to use. Petitioners now say that §14(a) required Kirby to have offered these 12 cumulative documents in evidence in *Zenn.* They add that the New York court's failure to enforce such a burden on Kirby in *Zenn* was not error, but something more, converting its judgment into a nullity, and justifying collateral attack in the name of "fraud." Thus petitioners argument would achieve the same result advocated by Phillips—complete preemption.

Since the substance of Phillips' argument runs through the petitioners' brief, there is no need for an additional brief.

4. Kirby was made a party to the final judgment in *Zenn*, and is entitled to the protection of that judgment as res judicata.

Phillips cannot be heard to urge that Kirby be estopped to claim the benefit of the state judgment as res judicata on the jurisdictional issue. Kirby expressly consented to the jurisdiction of the *Zenn* court for the purpose of its entry of the judgment approving the settlement, which is here under collateral attack (R. 2112).

No settlement of litigation would ever be undertaken if the parties did not believe that a court's judgment approving that settlement after a full hearing was protected by the principle of res judicata, and entitled to full faith and credit. Indeed, one of the principal purposes of the *Zenn* court's decision was "to bring an end to this protracted litigation with its attendant expenses and constant demands upon the time of Alleghany's officers." (Ex. K-138, R. 1719)

5. Phillips' Motion is untimely and otherwise objectionable.

Phillips protests that his motion is timely because made within only two weeks of the time he learned of petitioners' "abandonment" of their question 5 on the jurisdiction of the *Zenn* court. He claims "a double interest in this case," both as a holder of 100 shares of Alleghany stock since November 1954, and as "a representative of the stockholders' group" from whom "the suppressed documents described by petitioners' brief herein were withheld" (Motion, p. 2; Br. p. 2).

Phillips' claims here are dubious. His acquisition of Alleghany stock in November 1954 (shortly after the *Zenn* action was commenced by others, and long after the 1949-50 exchange complained of therein) gives him no special standing in equity. Phillips was present and participated as a defendant throughout the trial below, during which 'petitioners' counsel repeatedly charged that the *Zenn* court had been defrauded by the concealment of various documents marked in evidence. At no time did Phillips indicate or express any opinion that he or his "group" had been defrauded by the failure of anyone to adduce evidence, nor did he so testify below when this charge was presented. As a "representative" of the stockholders group who "negotiated the Kirby settlement at issue here" (Motion, p. 2), Phillips was one of the foremost "proponents" of the settlement when it was finally submitted to and approved by the New York Supreme Court. His concern at this late date because of his disagreement with the approach in petitioners' brief is hardly ground for an eleventh hour motion made two weeks after the time for filing a brief amicus had expired (Sup. Ct. Rule 42(2)).*

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* The brief also contains several baseless charges of personal wrongdoing (R. 183-84). Thus, at p. 3 of his brief, Phillips asserts that Pomerantz, attorney for the *Zenn* plaintiffs, was found guilty of "'unconscionable conduct'" by the federal court in 1955. However, a reading of the opinion cited and quoted by Phillips fails to reveal any such finding, and none was in fact made. *Breswick & Co.* v. *Briggs,* 135 F. Supp. 397, 403, 406 (S.D.N.Y. 1955).

Again, at p. 21, Phillips refers to what Judge Moore "stated with respect to the transaction 'whitewashed' by the Referee." One may search Judge Moore's opinion in vain for the quoted characterization supplied by Phillips. Judge Moore did say that "as long as there are lawyers there will be expressions of honest belief that better settlements could have been obtained had subsequent counsel been in charge initially." (R. 2343).

We do not remark on the comments of like character concerning the payment of the Referee's fee and attorney Pomerantz's fee (Br. p. 21).

Phillips accepted the jurisdiction of the *Zenn* court in 1959, and is collaterally estopped from attacking it here. *Caterpillar Tractor Co.* v. *International Harvester Co.*, 120 F. 2d 82, 84 (3rd Cir. 1941).

Conclusion

Recognizing their failure of proof on the case against Kirby, which was the only one pleaded and tried (R. 174-75), and their equal failure of proof on their new case against Young and Purcell, first asserted before the Court of Appeals and now presented (without benefit of pleadings or trial) on the strength of a dissent below, petitioners have turned to their argument based on §14(a) of the Securities Exchange Act, raised in this Court for the first time, in a final effort to reopen this bitter episode in the corporate war between Allan P. Kirby and the Murchison brothers.

Since petitioners' argument is the functional equivalent of Phillips' contention under question 5 of the Questions Presented in the Petition for Certiorari, there is no need here for an additional brief on the point.

In the event, however, that this Court should grant Phillips' motion, we respectfully request (1) permission to file a reply brief with the Court and (2) fifteen (15) minutes additional time for oral argument in reply thereto.

Respectfully submitted,

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To be argued by
THOMAS F. DALY

Supreme Court

OF THE STATE OF NEW YORK,

APPELLATE DIVISION—FIRST DEPARTMENT

SADIE ZENN, *et al.*,
Plaintiffs-Respondents,

against

J. J. ANZALONE, *et al.*,
Defendants-Respondents.

SAMUEL R. ROSEN,
Petitioner-Appellant.

BRIEF FOR DEFENDANTS-RESPONDENTS YOUNG, ET AL.

This is an appeal from an order of the Supreme Court, New York County (by Mr. Justice McGivern), denying appellant's motion to vacate an order of reference previously entered in this action.

This action arises from the consolidation of ten stockholders' derivative suits brought on behalf of defendant Alleghany Corporation ("Alleghany" hereinafter). The actual defendants are present and past directors of Alleghany and other persons allegedly associated with them.

The parties agreed to settle the action subject to court approval. Upon Alleghany's application

(229), the Court below (by Mr. Justice McGivern) entered its order of August 18, 1955 appointing a Referee to hear and report on the fairness of the proposed settlement and directing that all stockholders of Alleghany be notified of the hearing (211). A notice approved by the Court and setting forth the full terms of the settlement agreement was sent to the stockholders (223, 244). The hearings before the Referee commenced on September 19, 1955 (127) and have been regularly continued. Their transcript comprises more than 2,000 pages to date and close to 400 exhibits have been marked in evidence.

Appellant is one of a group who have announced their intention of conducting a proxy fight to oust the present management of Alleghany, including some of the present defendants, see *Rosen* v. *Alleghany,* 133 F. Supp. 858 (S. D. N. Y., 1955), and the instant action is a part of their campaign.

Appellant Rosen, not a party to this action, is a stockholder of Alleghany and has, as such, actively participated in the hearings (127-8). After two unsuccessful attempts by appellant's attorneys to stay these hearings in the federal court (124-6), he moved in the Court below on September 15, 1955 for a stay of the settlement hearings and for an order directing Alleghany to issue a supplemental notice to stockholders advising them of the pendency of a companion action in the federal court (21-3). The Court below (by Mr. Justice McGivern) denied this motion on September 28, 1955 (126-7); and no appeal has been taken from this order.

Thereupon, on October 6, 1955, appellant Rosen moved to vacate the order of reference altogether (13). Appellant made this motion seven weeks

after the order of reference and long after the commencement of the settlement hearings. He offers no excuse for this delay. His asserted grounds are (1) that the Court lacks jurisdiction of one of the numerous claims involved in this action; (2) that the proponents of the settlement have "unclean hands" because they did not inform Mr. Justice McGivern of the pendency of a related action in the federal court; and (3) that the notice of hearing sent to the stockholders was inadequate (26-7; App. Br. 2). From the order of Mr. Justice McGivern denying this motion (7), Rosen has taken this appeal.

POINT I

The Court below has jurisdiction to determine the fairness of the proposed settlement because none of the causes of action herein is subject to exclusive federal jurisdiction.

Appellant contends that the Court below lacks jurisdiction to pass upon the proposed settlement because, so he claims, the first cause of action of the complaint herein is based upon the Securities Exchange Act of 1934 whose § 27 provides for exclusive federal jurisdiction. Concededly, the other seven causes of action (alleging an even greater number of charges of wrongdoing) are within the Court's undisputed jurisdiction.

Appellant's contention is predicated upon the allegation of the complaint that a proxy statement issued by Alleghany violated the Exchange Act (313). That allegation, however, must be read in the context of the factual allegations set forth in the first cause of action. Appellant carefully refrains from summarizing those facts. Upon consideration of those facts it will be seen that:

(a) The first cause of action states facts constituting ordinary common law fraud and deceit (and states a cause of action sounding in conspiracy and another for failure of the defendants to conform to the terms of the board resolution authorizing the transaction attacked) as to which the Court's jurisdiction is unquestioned;

(b) The sufficiency of the cause of action would not be impaired if the allegation of violation of the Exchange Act were eliminated from the complaint; accordingly

(c) Upon identical facts the federal court has held not only that it lacks exclusive jurisdiction of a claim of this character, but that it has no jurisdiction at all. *Lapchak* v. *Sisto,* C. C. H. Fed. Securities Law Reporter, No. 90721 (D. C., S. D. N. Y., opinion of July 20, 1955, by Dimock, D. J.). A copy of the *Lapchak* opinion is set forth in the record (148-162). Judge Dimock held that the plea of violation of the Exchange Act was "either mere surplusage or a mere pretext for assertion of federal jurisdiction" (161).

Although the *Lapchak* opinion was forcefully called to appellant's attention in the Court below (130), appellant passes it over in silence—apparently in the hope of having the last word in an attempt to distinguish that case in his reply brief.

We proceed to show the complete analogy of the first cause of action at bar to the claim alleged in *Lapchak* v. *Sisto, supra.*

The first cause of action here alleges, in short (290-316): In 1949 Alleghany owned substantial amounts of the stock of a corporation known as Investors Diversified Services, Inc. ("IDS" here-

inafter). (297-9). In December 1949 Alleghany's board of directors resolved to permit Alleghany's officers to exchange preferred stock of Alleghany held by them for some of the IDS stock owned by Alleghany; the exchange was to be subject to stockholder approval (299-300). Two of Alleghany's officers, the defendants Young and Kirby, accepted that offer and tendered a large amount of Alleghany preferred stock to be exchanged for IDS stock (300-2). Alleghany thereupon solicited stockholder approval of this exchange by means of a proxy statement which was false and misleading in that it failed to reveal various facts indicating that the IDS stock to be surrendered by Alleghany had much greater value than the preferred stock which Alleghany was to receive (302-4, 309-13). On the strength of the proxies procured through this proxy statement, Alleghany's management secured stockholder approval of the exchange (314) which was thereupon consummated (305-7).

In addition to these factual averments, the complaint states as a conclusion of law that the proxy statement violated § 14(a) of the Exchange Act, 15 U. S. C. § 78n(a).

Compare these allegations with those in *Lapchak* v. *Sisto, supra.* That was a stockholder's derivative action brought on behalf of Barium Steel Corporation. The complaint alleged that some of Barium's officers, together with their associates, owned the stock of a corporation known as Republic Industries, Inc. The directors of Barium resolved to acquire the Republic stock and to issue new Barium stock in exchange therefor. In order to carry out the plan, it was necessary to increase Barium's authorized capital stock. Barium's management solicited the stock-

holders' approval of the capital increase by means of a proxy statement which was false and misleading in that it failed to set forth various facts indicating that the stock to be issued by Barium had much greater value than the Republic stock which Barium was to receive. On the strength of the proxies procured through this proxy statement, Barium's management obtained the necessary stockholders' approval of the capital increase; and the exchange of Barium stock for Republic stock was thereafter carried out.

In addition to these factual allegations, the Barium complaint stated the legal conclusion that the proxy statement violated § 14(a) of the Exchange Act; and it invoked federal jurisdiction on the basis of § 27 of the Exchange Act, 15 U. S. C. § 78aa.

Such being the allegations of the *Lapchak* complaint, Judge Dimock held (153, 159-62):

> "I am convinced that this court has no jurisdiction over the subject matter of this action. • • •
>
> "Even plaintiffs concede that if the proxy statement were followed by a fair exchange the directors would not be liable to the corporation. Also, it is clear that, had the proxy statement been perfectly lawful but followed by an unfair exchange, the directors would be liable for damage sustained and profits realized in violation of their fiduciary duties.
>
> "The common plan, as plaintiffs allege it, was to foist a less valuable block of stock of Republic upon Barium in exchange for a more valuable block of stock of Barium. The increased authorization and related false proxy statements were merely incidental to the plan. Since the liability asserted by plaintiffs may be proved without regard to the proxy state-

ments and cannot be proved without regard to the alleged breach of fiduciary duty it is impossible to say that plaintiffs are asserting a right under or created by a federal law. The allegations as to the proxy statements are either mere surplusage or a mere pretext for assertion of federal jurisdiction. [Citing authorities.]

"The motions to dismiss are granted on the ground of lack of federal jurisdiction."

The complaint in *Lapchak* v. *Sisto, supra,* is in all essential respects analogous to the first cause of action at bar. There, as here, the corporation was to exchange stock owned by it for stock owned by its directors. There, as here, the exchange required stockholder approval. There, as here, stockholder approval was secured by a proxy statement alleged to have been false and misleading in that it failed to set forth various facts showing the disproportion between the value of the stock to be surrendered and the value of the stock to be acquired by the corporation. There, as here, the proxy statement was alleged to violate § 14(a) of the Exchange Act. There, as here, the approval of the stockholders thus secured was followed by the actual consummation of the exchange. The federal court's holding that it was without jurisdiction under § 27 of the Exchange Act compels the conclusion that the first cause of action at bar is likewise outside the scope of federal jurisdiction—and certainly not subject to the exclusive jurisdiction provided by § 27.

We submit that this decision of the federal court concerning its own jurisdiction carries more than the ordinary weight in this Court. Just as federal courts yield to the construction of state law by state courts (*Erie R. Co.* v. *Tompkins,* 304 U. S. 64), so the state courts yield to the delimitations

of federal jurisdiction announced by federal court decisions.

In this case, Judge Dimock's decision in the *Lapchak* case gains added weight from the recent decision of the Court of Appeals for the Second Circuit in *Subin* v. *Goldsmith*, 224 F. 2d 753 (C. A. 2, 1955). The complaint there, like the first cause of action at bar, stated a claim based upon a proxy statement alleged to have been false and violative of § 14(a) of the Exchange Act. The majority of the Court said (224 F. 2d, at 774):

> "*In limine* it is at least doubtful that it was the intention of the Congress to create any substantive rights by the provisions of Sections 14(a) and 29(b) of the Security Act."

We submit that the Court has jurisdiction to approve the settlement of the first cause of action herein and that § 27 of the Exchange Act in no wise impairs that jurisdiction.

Appellant's brief (pp. 12-13) charges that we have elsewhere expressed the belief that the claim alleged in the first cause of action could be predicated on the Exchange Act. A careful reading will show that our own statements said only that the complaint alleges a violation of the Securities Act of 1934. This is patently true. We have never conceded that there is a cause of action which arises from such a violation. The *Lapchak* and *Subin* cases now establish that there is no such cause of action.

POINT II

Even if (contrary to the *Lapchak* case, *supra*) the Securities Exchange Act aspects of the first cause of action were cognizable in the federal court, the state court would still have jurisdiction to pass upon the common law fraud claim alleged in the first cause of action.

We shall assume, for argument under this point-head, that the first cause of action, so far as it alleges a violation of the Exchange Act, is cognizable in the federal court pursuant to § 27 of that Act. The first cause of action alleges, however, facts sufficient to constitute a claim for common law fraud and deceit. We shall show that the Court below is not prevented by § 27 of the Exchange Act from approving a settlement of that common law claim.

1. The allegation of the complaint that Alleghany's proxy statement violated the Exchange Act is a bare conclusion of law. Stripped of that legal conclusion, the first cause of action clearly alleges facts constituting a claim for common law fraud. § 28(a) of the Exchange Act, 15 U. S. C. § 78bb(a), expressly preserves plaintiffs' right to prosecute that claim in the state court, unhampered by the jurisdictional limitations of § 27. So far as here pertinent, § 28(a) of the Exchange Act provides:

> "The rights and remedies provided by this chapter shall be in addition to any and all other rights and remedies that may exist at law or in equity; but no person permitted to maintain a suit for damages under the provisions of this chapter shall recover, through satisfaction of judgment in one or more ac-

> tions, a total amount in excess of his actual damages on account of the act complained of. • • •"

The impact of this provision upon the case at bar is plain. To the extent that (contrary to the *Lapchak* case, *supra*) the claim may be said to rest upon a violation of the Exchange Act, it is subject to the exclusive federal jurisdiction. But to the extent that the same facts spell out a claim for common law fraud, plaintiffs are free to assert it in the state court, and the state court has unquestionable jurisdiction to approve the settlement of that claim.

Any different conclusion would lead to intolerable results. For illustration we refer to § 10(b) of the Exchange Act, 15 U. S. C. § 78j(b), which forbids fraud in the sale of securities. It is well settled that a defrauded purchaser of securities may sue the seller for damages under this provision; *Fischman* v. *Raytheon Mfg. Co.*, 188 F. 2d 783, 787 (C. A. 2, 1951); *Fratt* v. *Robinson*, 203 F. 2d 627 (C. A. 9, 1953). If the defrauded purchaser asserts his claim under the Exchange Act he must, of course, proceed in the federal court. But that possibility does not preclude him from asserting a claim for common law fraud; and if he asserts that claim in the state court, § 28 of the Act clearly preserves for him that state court remedy. As was held in *Abraham* v. *Selig*, N. Y. L. J. 1939, p. 2709, col. 3 (Sup. Ct., N. Y. Co., not otherwise reported; opinion quoted in full):

> "The complaint contains 61 causes of action on behalf of 33 plaintiffs. Thirty-eight of the causes, which are substantially identical, are alleged against the defendants comprising the firm of Homes & Davis, who move to strike certain allegations from each of the 38 causes, or, in the alternative, to require an amended

complaint separately stating and numbering the two distinct causes stated in each of the 38 causes. It is contended that each cause alleges a common-law action in fraud and deceit and a statutory action under the provisions of the Securities Exchange Act of 1934, and that the allegations relating to that act should be stricken. The act, however, specifically provides that all remedies created by it and enforceable in the federal jurisdiction only, shall be in addition to all other existing rights and remedies. Thus plaintiffs are not precluded from proceeding upon the common-law cause for fraud and deceit. They may also rely upon incidental violations of the act as constituting part of the alleged wrong. The motion is therefore denied. Order signed."

The decision demonstrates these propositions relevant to the case at bar:

(a) The same facts may give rise to a statutory claim under the Exchange Act and to a common-law claim for fraud.

(b) Although the statutory claim is subject to exclusive federal jurisdiction, the concomitant common law claim is cognizable in the state court.

(c) The state court does not lose jurisdiction of the common law claim even though the complaint contains an incidental allegation that the Exchange Act was violated.

The first cause of action at bar states facts constituting a common law claim for fraud and is therefore cognizable in the state court. Even if the same facts should be held to give rise to a statutory claim which would be subject to exclusive federal jurisdiction, § 28 of the Act would nevertheless preserve the state court's jurisdic-

tion over the common law claim. The allegation that the proxy statement violated the Exchange Act is at most conclusory and incidental and does not destroy the jurisdiction of the state court.

The same conclusion was reached in two Delaware cases, both entitled *Kaufman* v. *Shoenberg*, one decided by the Court of Chancery and the other by the federal District Court. In both cases a stockholder attacked the same stock option plan upon the ground, among others, that the stockholders' approval of the plan had been secured by a false proxy statement. In the state court action the plaintiff based his claim upon the common law, in the federal court upon the alleged violation of the Exchange Act. The state court action was the first to go to trial; the Chancellor entertained jurisdiction and dismissed the claim on the merits because the proxy statement was not false. *Kaufman* v. *Shoenberg*, 91 A. 2d 786, 790-1 (Del. Ch., 1952). The defendants then moved for summary judgment in the federal court on the ground of *res judicata*. The court's attention was called to an earlier Delaware decision (*Investment Associates* v. *Standard Power & Light Corp.*, 29 Del. Ch. 225, 48 A. 2d 501, aff'd 20 Del. Ch. 593, 51 A. 2d 572) which had held that the state court could not pass upon violations of the Exchange Act. But since the state court's decision in *Kaufman* was based only upon the common law, the federal court recognized it as valid and binding. It also sustained the defense of *res judicata* on the ground that the federal claim under the Exchange Act was coterminous with the common law claim for fraud and that "the gist of the two actions [was] the same."

A copy of the unreported opinion of the federal court in *Kaufman* v. *Shoenberg* (D. C. Del., Civil

Action 1413, February 15, 1954, by Rodney, D. J.), will be submitted at the argument of this appeal.

We submit that the Court below has jurisdiction of the common law claim for fraud alleged in the first cause of action. It has power, therefore, to pass upon the fairness of the settlement of all causes of action herein, including the first. And if, as we are confident they will, the Referee and Mr. Justice McGivern find on the full record that the proxy statement was not false or misleading, that finding and/or the Court's judgment will conclude the federal question, if any.

2. None of the authorities cited in appellant's brief (pp. 10-11) militates against our position.

American Distilling Co. v. *Brown*, 295 N. Y. 36 (1945), was an action to recover so-called short-swing profits of corporate insiders under § 16(b) of the Exchange Act, 15 U. S. C. § 78p(b). Claims of this character have their sole basis in the Exchange Act; they are created by statute and have no counterpart in the common law. The Court of Appeals was therefore clearly right in dismissing the action as being subject to the exclusive jurisdiction of the federal courts. The question here presented—whether the state court may retain jurisdiction of a concomitant common law claim for fraud—could not arise in the *American Distilling* case for the simple reason that, upon the facts there alleged, no such common law claim existed.

Equally inapposite is *Standard Power & Light Co.* v. *Investment Associates*, 20 Del. Ch. 593, 51 A. 2d 572 (1947). The plaintiffs there attacked an election of corporate directors on the ground that their opponents had solicited stockholders'

proxies without furnishing a written proxy statement as required by SEC Rule X-14A-1. Again the requirement to furnish a written proxy statement rested exclusively upon the Exchange Act and the regulations issued thereunder; it had no counterpart at common law. The Delaware court was therefore clearly right in refusing to pass upon the alleged violation of the Exchange Act. The court indicated however that it would have been willing to pass upon the merits of the plaintiff's contention if it had been based upon state law (51 A. 2d, at 579):

> "The solicitation, the proxy, and the voting of the same have not been challenged under the provisions of the General Corporation Law of this State."

Since the first cause of action at bar states facts constituting a common law claim under the laws of this State, the *Standard Power & Light* case is clearly beside the point, as appears from *Kaufman* v. *Shoenberg, supra.*

Eliasberg v. *Standard Oil Co.*, 23 N. J. Super. 431, 92 A. 2d 862, 868-9 (1952), aff'd 12 N. J. 467, 97 A. 2d 437 (1953), is authority for our position rather than appellant's. A stockholder there attacked a stock option plan on the ground that the approval of the plan by stockholders had been procured by a misleading proxy statement. The court held that it could not pass upon the alleged violation of the Exchange Act since that was a matter of exclusive federal jurisdiction. But since the claim was also maintainable at common law, the court proceeded to consider it on the merits and dismissed it, not for lack of jurisdiction, but for lack of factual foundation. By the same token, the Court below may pass upon the common law fraud claim alleged herein even though the viola-

tion of the Exchange Act might be deemed to be beyond its jurisdiction.

Appellant's last authority is *In re R. Hoe & Co.*, 137 N. Y. S. 2d 142 (Sup. Ct., Bx. Co., 1954). That case involved a petition to set aside the election of corporate directors upon the principal ground that false proxy material had been used. The court, far from rejecting jurisdiction, determined the claim on its merits. The only issue upon which the court refused to pass was the petitioner's contention that three items used in the solicitation of proxies had not been cleared with the SEC, as required by SEC Rule X-14A-6(d). Since that requirement was of purely statutory origin, without any counterpart in the common law, we have no quarrel with the decision. For the reasons we have repeatedly stated it has clearly no application to the case at bar.

3. We submit that for all the reasons stated in this and the preceding point of this brief, appellant's attack upon the jurisdiction of the Court below is unfounded. We add, however, the final observation that appellant's attack on the proceedings below is in any event premature.

Alleghany has applied to the Court below for an inquiry into and the approval of the proposed settlement. The Court below has, so far, neither granted nor denied the application. What it did do was to appoint a Referee in order to assemble and report on all relevant facts and considerations bearing upon the requested approval of the settlement. Among the matters thus to be considered by the Referee and by the Court below are the extent to which the Court has power to approve the settlement. If the Referee or the Court below should conclude that any part of the proposed

settlement cannot be passed upon by the state court, they will doubtless so advise the parties and notify them either to limit their settlement or to eliminate from the complaint the reference therein to the Exchange Act. If such a suggestion should be made and if it should be adopted by the parties, the issue presented by appellant would become moot. We submit, therefore, that appellant's present jurisdictional attack is premature and that this Court should defer consideration thereof until such time as a judgment of the Court below approving the proposed settlement may be presented to this Court for review.

POINT III

Appellant's charge of "unclean hands" is unfounded and should, in any event, be addressed to the Referee (before whom appellant is making the very charges he is now pressing upon this Court).

After the parties had entered into the stipulation of settlement it became the duty of the attorney for Alleghany to submit it to the Court below for its approval or disapproval. He did precisely that: By motion of July 27, 1955 (229) he moved "for judicial inquiry into and determination on the merits of the fairness, reasonableness and adequacy of said stipulation of settlement and the settlement of the action provided for therein, and for the approval thereof." His moving affidavit (235) set forth the complete terms of the stipulation of settlement; it summarized the nature of the action and the pleadings; it referred to the extensive discovery proceedings and depositions had in this and a companion action in the

federal court; and it stated that extended negotiations had preceded the settlement agreement. The Court below thereupon entered its order of reference (211).

We submit that Alleghany's procedure was altogether proper and in accordance with familiar practice long established in the settlement of stockholders' derivative actions.

The gist of appellant's attack on this procedure is his claim that "the proponents of the settlement concealed from the Court below material facts with regard to actions pending in the Federal Court on behalf of Alleghany" (App. Br., p. 2). It is thus necessary to give a brief description of the proceedings in the Supreme Court and in the federal court.

The various stockholders' suits consolidated herein were, for the most part, commenced in or about April 1954 and were consolidated in June 1954. Simultaneously a number of similar actions were commenced in the federal District Court for Southern New York and were there likewise consolidated under the caption *Zenn et al.* v. *Anzalone et al.* (Civil No. 92-205). In both actions the firm of Pomerantz, Levy & Haudek was designated as general counsel for the plaintiffs. This firm conducted extensive depositions and discovery proceedings (240). It was this firm which negotiated the settlement with defendants.

In February 1955 two other stockholders of Alleghany commenced a derivative action in the same federal court entitled *Breswick & Co. et al.* v. *Briggs et al.* (Civil No. 98-371). This was some ten months after the commencement of the *Zenn* case and eight months after the orders of consolidation were entered both in the federal and state

courts. The plaintiffs in the *Breswick* action were represented by Rosston, Hort & Brussel, Esqs., which firm also acts as co-attorneys for appellant Rosen in the hearings before the Referee herein (123-4). The amended complaint in the *Breswick* action alleges some, but not all, of the claims which are being asserted herein (24).

On June 6, 1955 Breswick & Co. and one Randolph Phillips commenced another action in the federal court—not a derivative suit—in which Alleghany and the Interstate Commerce Commission were named as defendants. That action was brought to set aside certain orders of the Interstate Commerce Commission which, among other things, continued Alleghany under I.C.C. regulation and authorized Alleghany to issue a new class of preferred stock in exchange for its outstanding Series A Preferred stock. A temporary injunction was issued in that case by a statutory three-judge court on July 21, 1955, the court saying that Alleghany had become an investment company subject to S.E.C. rather than I.C.C. jurisdiction; *Breswick & Co.* v. *United States*, 134 F. Supp. 132. (The report omits the dissenting opinion of Judge Hincks.)

These were the proceedings pending at the time Alleghany applied for the settlement hearings on July 27, 1955.

We turn to a consideration of the inequities and frauds which were allegedly perpetrated by the proponents of the settlement and which are said to contaminate the proposed settlement to such an extent that this Court should bar the Trial Court from receiving any evidence on the fairness of the settlement.

1. The three-judge court action.

Appellant argues that our settlement, if approved by the Court, would barter away the claimed Breswick victory before the three-judge court. He wholly omits to inform this Court that the settlement herein, in express terms, excludes from its scope all the issues litigated before the three-judge court. Thus the stipulation of settlement which was before Mr. Justice McGivern when he ordered the reference defines with meticulous precision the issues which were not to be included in the settlement—and they are precisely the issues before the three-judge court (258-260):

> "• • • this stipulation, and all proceedings, notices and acts connected therewith shall be without prejudice to:
>
> (a) Any judicial or administrative decision, ruling or determination concerning Alleghany's obligation, if any, to register under and otherwise conform to the Investment Company Act of 1940, United States Code, Title 15, Secs. 80a-1, et seq.;
>
> (b) The Claim alleged in the complaint for an injunction against the proposed exchange by Alleghany of its 5½% Series A $100 Par Value Cumulative Preferred Stock against its new 6% $10 Par Value Convertible Preferred Stock."

The stipulation of settlement, with these qualifications, was part of the notice sent to the stockholders.

What, then, is left of appellant's contention? He argues, or at least asserts, that the impact of the interlocutory decision of the three-judge court materially enhanced the value of the derivative claims asserted in this Court; and that the failure to disclose that decision to Mr. Justice

McGivern, in applying for the order of reference, constituted the withholding of a material fact. Appellant's argument is shot through with fallacies.

(a) Let us assume, arguendo (but see *infra*), appellant's premise that the three-judge decision did enhance the value of the claims being settled. Even so, that decision was but one among a great number of factors which might either strengthen or weaken the claims herein. It has never been the practice—and it would be a senseless procedure—in an application for a settlement hearing to inform the Court, in advance of the hearing requested, of all the material facts which may tend to support or to negate the liability of the defendants. The very purpose of the hearing requested is to afford a forum to ascertain the material facts. If, as appellant contends, the interlocutory three-judge decision has a material bearing on the merits of this case, then the time so to argue is at the hearing—not in connection with the application for the hearing.

The rule contended for by appellant—that facts bearing on the pros and cons of the proffered settlement must be made known to the Court in connection with an application for a settlement hearing—misconstrues the nature of the application. The application for a hearing or reference is not designed to persuade the Court that the settlement is fair and adequate. It merely asks the Court to set in motion the machinery by which the adequacy or inadequacy of the settlement may be determined. Both common sense and uniform procedure rebel at the suggestion (implicit in appellant's charge) that a motion to hear the evidence of the material facts must set forth those facts themselves.

In fact, the decision of the three-judge court was placed in evidence before the Referee at the very opening of the hearings. Counsel for appellant has been strenuously arguing to the Referee that that decision furnishes strong support for the claims sought to be settled. The Referee, the Court below and, upon review, this Court will thus have every opportunity to give that decision such weight as it may be entitled to in conjunction with all other facts bearing upon the merits or demerits of this litigation and the adequacy of the proposed settlement. But it is fatuous to claim that the three-judge decision had any material bearing upon the granting of the reference as such.

(b) We have thus far assumed that the three-judge decision—as appellant asserts—materially enhanced the value of the claims to be settled. The opposite, however, is true.

The very intricate question of the impact, if any, of the three-judge decision on the claims now being settled is not and was not before the three-judge court. In its final opinion of November 18, 1955, that court states in passing:

> "There is not before us the question whether Alleghany may be liable to Preferred stockholders for any loss that they may suffer."

This comment plainly suggests that Alleghany is more likely to incur liabilities than to acquire rights against others if it was subject to the provisions of the Investment Company Act regarding unregistered investment companies.

Appellant's argument runs into another difficulty. The interlocutory three-judge decision on which he relies has now been superseded by the

final decision of November 18, 1955. That decision renders it, to say the least, extremely doubtful whether Alleghany was subject to the Investment Company Act at the time of any of the transactions (other than the exchange offer) alleged in the complaint.

Moreover, the various retreats and indications of uncertainty in the recent opinion of the three-judge court (which includes Judge Walsh) lend support to our belief that, when all the facts are known, the defendants will be found to have a complete defense to all liability under the Investment Company Act by virtue of the good faith provision of Section 38(c) of that Act.

These considerations cannot, of course, be fully expounded within the confines of this brief. They concern the merits of the settlement which are not in issue upon this appeal. They confirm, however, our position that the three-judge court proceedings had no bearing whatever upon the granting of the reference as such and that, in any case, the issue is now sub judice before the Referee at Special Term.

2. The Breswick derivative action in the Federal Court.

Again appellant contends that the order of reference is vitiated because, in applying for it, Alleghany failed to disclose to Mr. Justice McGivern that "the Breswick action was being actively prosecuted in the United States District Court for the Southern District of New York, and that a motion for summary judgment for plaintiffs had been made and was pending therein" (App. Br. 16).

The argument is nothing short of captious.

To begin with, the "active" prosecution of the *Breswick* derivative action consisted of a motion for a temporary injunction which was denied (*Breswick* v. *Briggs*, 130 F. Supp. 953), and a motion for summary judgment which was likewise denied (87). On the other hand, it was general counsel for the plaintiffs herein who conducted depositions and discoveries and amassed the documentation which is currently being placed before the Referee in staggering volume.

Secondly, the *Breswick* derivative action was commenced ten months after the action at bar. It alleges some, but not all of the causes of action set forth in the present suit. So did other stockholders' actions, also not consolidated with the Zenn action, which like Breswick asserted overlapping claims. Since the Court below was apprised of the issues in the suit at bar, no useful purpose would have been served by enumerating the various duplicatory actions pending in another forum.

Thirdly, the very order of reference required that notice of the settlement hearings be sent to all stockholders. The Breswick plaintiffs were thus notified of the hearings and given an opportunity to present all their evidence and arguments. Of this opportunity, counsel for Breswick have availed themselves to the hilt.

Appellant's contention that the pendency of the *Breswick* action and its vigorous prosecution were "material" facts which were withheld from Mr. Justice McGivern when a settlement reference was requested necessarily implies that, had Mr. Justice McGivern been informed of these facts, he might have refused to order an inquiry into the fairness of the settlement. A mere state-

ment of the proposition would seem sufficient to refute it.

3. The charge that the settlement was reached with undue haste.

Appellant next argues that the settlement was announced only four days after the decision of the three-judge court. The implication seems to be that the settlement was reached hastily in an attempt to escape the effects of that decision.

This argument of appellant seeks to impugn the fairness and good faith of the settlement. But that very question is now pending before the Referee where counsel for the appellant has cross-examined at great length on that issue. One of the factors bearing upon the fairness of the settlement may be the manner in which it was reached. If it should develop at the hearings that the proposed settlement was reached with undue haste and in an inequitable manner, the Referee and the Court below will take that fact, if it be one, into account. But appellant would have this Court condemn the settlement in total disregard of the evidence which is being assembled before the Referee on this very issue. Such procedure would put the cart before the horse. Our courts render their judgments after trial, not before.

The record here shows that the settlement was not reached hastily but after "extended negotiations" (240). We expect to show before the Referee that discussions commenced in the summer of 1954 and proceeded on and off until an oral agreement for settlement was reached on April 18, 1955—long before the three-judge court proceedings were even commenced. If the Referee and the Court below accept our evidence, it will

refute appellant's charge that the settlement was reached with undue haste and in an inequitable manner.

4. The claimed inadequacy of the settlement.

Appellant's final contention is that the amount of the settlement is inadequate and that the defense of good faith interposed by defendants is unfounded. It is, however, too plain for argument that the sufficiency of the settlement and the merits of the defenses are the very subjects to be determined, in the first place, by the Referee, then by the Court below and, finally, upon appeal, by this Court. Those matters are to be determined upon evidence, not on the mere say-so of appellant.

We submit that appellant's charge that the proponents of the settlement came into the Court below with "unclean hands" is utterly unfounded and should be rejected. Far from suppressing any material facts, the proponents instituted the procedure best designed to place all the material facts before the Court. Appellant's motion, if granted, would have suppressed the truth. The Court below was clearly right in denying the motion.

POINT IV

The notice to stockholders was adequate.

Appellant's brief attacks the adequacy of the notice sent to the stockholders mainly because the notice summarized the nature of plaintiffs' charges instead of setting forth a detailed summary of the various allegations of wrongdoing alleged in the complaint. No such objection to the notice was ever presented to the Court below (50-52). It should therefore be rejected out of hand.

In any event, appellant omits to inform the Court that the notice expressly invited the stockholders to inspect the pleadings which were open for inspection at the office of general counsel for the plaintiffs and of the attorney for Alleghany (227-8). Any stockholder wishing to acquaint himself with the detailed nature of the controversy was thus placed in a position to do so; and a great many availed themselves of that opportunity. The effectiveness of the notice is confirmed by the fact that, at the opening of the settlement hearings, the large Byrne Room of the Association of the Bar of the City of New York was filled to capacity by attending shareholders and their counsel.

Any attempt to summarize the complaint in the notice to stockholders in greater detail than was done would have obscured rather than illuminated. The copy of the complaint set forth in this record covers 65 printed pages (289-482). More important, however, than its length is the extreme complexity of the transactions set forth therein. Any effort at a more detailed summary would but have invited criticism of the paraphrase.

If the purpose of a notice of settlement is to ferret out all the potential opposition that resides in the ranks of the shareholders, may we submit as a practical matter that this notice has been extraordinarily effective. The hearings that are presently going on and have been going on over the past two months have elicited the most militant opposition that we have ever seen in a hearing of this character. Counsel for appellant, who correctly characterizes himself as leader of the opposition, has been granted and has availed himself of a virtually complete discovery and inspection of Alleghany's files. The major portion of the

transcript of hearings now comprising more than 2,000 pages consists of the cross-examination conducted by counsel for appellant and other objectants and of their offers of documentary and other evidence. Under these circumstances it is rather ironic for appellant to complain that the notice to stockholders might have been inadequate to afford complete protection to the stockholders.

Appellant next complains that the notice to stockholders did not mention the *Breswick* derivative suit and the three-judge court proceedings. The charge has been answered in a previous portion of this brief. The notice to stockholders did not purport to set forth any of the grounds which might tend to support or to defeat the liability of the defendants. There was no more reason to inform the shareholders of those two litigations than to inform them of the fact that in the course of the deposition of defendants taken by general counsel certain important admissions or denials were made by one or another witness. In accordance with usual procedure, Alleghany informed the shareholders of the broad issues sought to be settled, of the precise terms and conditions of the settlement agreement, and of their right and privilege to ask for and secure the voluminous pleadings herein and whatever other supporting detail they might wish.

To accept the proposed innovation of this appellant by requiring the notice to shareholders to set forth the pros and cons which tend to augment or diminish recovery, would invite prolixity and confusion in a notice which should be simple and clear. Moreover, no lawyer preparing such a notice, however careful, would be exempt from a charge that one or another of the many attorneys in the twenty or more companion litigations had

indeed done something of great importance which should be communicated to the shareholders. Down the road proposed by this appellant lies nothing but mischief. We submit that Alleghany's notice to the shareholders was fair and honest and in accordance with well established procedure in this type of case.

CONCLUSION

It is respectfully submitted that the order appealed from should be affirmed.

Dated, November 25, 1955.

Respectfully submitted,

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